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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN THE MATTER OF THE ARBITRATION BETWEEN: ELJER MANUFACTURING, INCORPORATED, formerly known as HOUSEHOLD MANUFACTURING, INCORPORATED,

Petitioner,

v.

KOWIN DEVELOPMENT CORPORATION,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Petitioner moved to vacate an arbitration award, pursuant to the Federal Arbitration Act, 9 U.S.C. § 10(a)(4), which provides for vacating an arbitration award if an arbitrator exceeds his or her powers or imperfectly executes them. Petitioner contended that an award of millions of dollars in "future lost profits" from an unsuccessful joint venture should be vacated, because it was based on *no* evidence. The Seventh Circuit held that challenges to the sufficiency of the evidence of an arbitration award do not trigger judicial review. The question presented is:

Whether federal courts are empowered to review an arbitration award, pursuant to the Federal Arbitration Act, 9 U.S.C. § 10(a)(4), and applying established judicial standards for limited review, to determine if the award is based on sufficient evidence or is not irrational?

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Petitioner,

v.

KOWIN DEVELOPMENT CORPORATION,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

Petitioner, Eljer Manufacturing, Incorporated, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit, entered on January 31, 1994.

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit is reported at 14 F.3d 1250 (7th Cir. 1994) and reprinted at page 1 of the appendix ("App.").

The opinion of the United States District Court for the Northern District of Illinois, Eastern Division (J. Moran) is reported at 822 F. Supp. 505 (N.D. Ill. 1993) and reprinted at App. 17.

JURISDICTION

In June, 1992, Petitioner Eljer Manufacturing, Inc., ("Eljer") formerly known as Household Manufacturing, Inc. ("Household") and Respondent Kowin Development Corporation, ("Kowin") submitted for arbitration alleged violations of the Racketeer Influenced and Corrupt Organizations Act, federal securities laws, state statutes and common law claims. Eljer is a Delaware corporation with its principal place of business in Dallas, Texas.[1] Kowin is a California corporation with its principal place of business in Montebello, California, and Dorothy Ko and Winston Ko, named in the award as successors-in-interest to Kowin, are California residents.

On October 30, 1992, the arbitrator issued an arbitration award in favor of Respondent. Petitioner invoked the jurisdiction of the United States District Court for the Northern District of Illinois under 28 U.S.C. § 1332 and 28 U.S.C. § 1331 and moved to vacate or modify the award pursuant to the Federal Arbitration Act, 9 U.S.C. §§ 10-11 (the "Act"). Respondent moved to confirm the award pursuant to the Act, 9 U.S.C. § 9.

On March 1, 1993, the district court modified in part and confirmed in part the arbitration award. (App. 17, 28) On March 9, 1994, the district court entered a reduced judgment in accordance with its Memorandum and Order. (App. 29) On January 31, 1994, on Petitioner's appeal, the United States Court of Appeals for the Seventh Circuit affirmed in part and modified in part the judgment of the district court, further reducing the arbitration award. (App. 1, 14)

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[1] Pursuant to Supreme Court Rule 29.1, Petitioner states that its parent corporation is Eljer Industries, Inc.

The Seventh Circuit denied Eljer's timely petition for rehearing with suggestion for rehearing *en banc* on March 4, 1994 and also denied Kowin's petition for rehearing. (App. 15) The Seventh Circuit granted Petitioner's motion for a stay of the mandate pending the filing of its petition for certiorari; the mandate was stayed to April 18, 1994. (App. 16)

The jurisdiction of this Court to review the judgment of the Seventh Circuit is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

9 U.S.C. § 10

Section 10 of the Federal Arbitration Act sets forth statutory grounds for the vacation of arbitration awards. The portion of § 10 relevant to this case provides:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—. . . (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

STATEMENT OF THE CASE

This case concerns an arbitration about a failed joint venture between Petitioner Eljer and Respondent Kowin to make metal files in the Peoples Republic of China. Pursuant to the Federal Arbitration Act, 9 U.S.C. §§ 10-11 and 28 U.S.C. §§ 1331 and 1332, Eljer challenged the resulting arbitration award on the basis, *inter alia*, that there was no evidence in the record to support the largest portion of the arbitrator's damage award (an award of

millions of dollars in "future lost profits" to an investor in a joint venture that never made a profit). The Seventh Circuit declined to review that part of the award. Contrary to numerous other circuits, and at odds with the public policy of encouraging arbitration, the Court of Appeals held that a challenge based on sufficiency of the evidence "simply does not trigger the review powers of this Court."

A. The Joint Venture

In 1984, Simonds Cutting Tools, N.A. ("Simonds"), a division of Household, Eljer's predecessor, entered into a written agreement with Kowin to form a new corporation, Kowin-Simonds, Inc. ("Kowin-Simonds"). In turn, Kowin-Simonds entered into a joint venture contract with the Beijing Steel Files Plant of Beijing, China (the "Joint Venture"). The Joint Venture was to manufacture metal files in China, some of which Simonds was to purchase and distribute. The Joint Venture failed to manufacture files that were competitive in the world market and never made a profit.

B. The Arbitration

On March 17, 1988, Kowin sued Household in federal court in California, alleging securities violations, fraud and breach of contract in relation to the formation and operation of Kowin-Simonds and the Joint Venture. As provided in the parties' written agreement, Household sought arbitration of the dispute. In December, 1989, the California court stayed the lawsuit and ordered the arbitration to proceed. The arbitration hearing occurred in Chicago, Illinois during the week of June 22, 1992, before a single arbitrator appointed by the American Arbitration Association.

On October 30, 1992, the arbitrator issued an award in favor of Kowin. While it is undisputed that Kowin lost only $1,210,792.00 in the Joint Venture, the arbitrator awarded Kowin a total of $14,844,858.00 in damages, interest totalling another $4,000,000.00, and attorney's fees. The award did not identify the cause, or causes, of action on which the arbitrator found liability. However, the award set forth three separate damage awards in the exact amounts Kowin had requested: (1) "out-of-pocket" damages of $2,960,542.00, (2) "future lost profits" of $8,384,316.00, and (3) "restitution" damages of $3,500,000.00.[2]

C. The Award of Future Lost Profits

The arbitrator's award to Kowin of $8,384,316.00 represented Kowin's 12½% share of the Joint Venture's assumed future lost profits over a twenty year period. The Joint Venture was a start-up manufacturing and distribution company that had no history of sales or profits. The sole basis for the arbitrator's award was a one-page five-year sales and profit projection for the Joint Venture; no one in the proceeding could identify the author of the five-year projections.

As to fifteen more years of future lost profits, the arbitrator accepted—and the district court and Seventh Circuit subsequently affirmed—Kowin's one paragraph of argument made for the first time in its Corrected Post

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[2] As discussed on pages 6-7 of this petition part of the award for out-of-pocket damages and all of the award for restitution have been vacated for material mistakes, after review by the district court and Court of Appeals. Although Eljer maintains that the entire award of future lost profits is based on profoundly insufficient evidence, this petition concerns only that part of the award which granted Kowin its proportionate share of an additional fifteen years of future lost profits from the Joint Venture.

Hearing Brief. Kowin contended that the Joint Venture would have earned twenty years of future lost profits—valued in today's dollars at $67,072,533.00. Kowin simply took the best year of profits from the unidentified five-year sales and profit projection and multiplied by fifteen to arrive at this twenty-year figure.

Kowin presented *no* evidence supporting its fifteen-year extrapolation. Respondent's own witnesses at the arbitration hearing concede that Household refused to commit to any sales projections beyond five years. Kowin's multiplication by fifteen to obtain lost profits beyond the five-year projection was not supported by *any* evidence regarding actual operations, actual sales, actual expenses, or actual profits for the Joint Venture—because there were none. There was no expert testimony in support of the claim, no evidence of expected long-term costs or profits, no evidence of profits on comparable projects, no evidence on possible changes in the market, no evidence on changes in the political or economic situation in China, no evidence on the nature of future competition from competitors such as Korea and India, nor any evidence on changes within the Joint Venture itself over twenty years. There was, in short, no basis in the record to support an award of millions of dollars in damages for future lost profits running into the next century on a business that never made a profit.

D. The Judicial Proceedings Below

On November 2, 1992, Eljer filed a Petition to Vacate the arbitration award. On November 5, 1992, Kowin filed a Motion to Confirm the award. The district court issued an opinion and order on March 1, 1993, vacating $1,250,000.00 of the award for out-of-pocket damages. (App. 23) This figure represented the portion of a loan that Household,

not Kowin, had repaid. The court also vacated $2,500,000.00 of the third award for restitution, because that amount was already included in the first award. (App. 26) Without discussion, the district court upheld the entire award of twenty years of lost profits, including the fifteen-year extrapolation. (App. 24-26) The district court entered judgment for Kowin and against Eljer for $12,199,622.00. (App. 29)

Eljer appealed and Kowin filed a cross-appeal. The Seventh Circuit issued an opinion on January 31, 1994. (App. 1, 14) The Seventh Circuit rejected Kowin's cross-appeal, affirmed the district court's reduction of the first and third damage award, and vacated the remaining $1,000,000 of the third award for restitution (which represented a loan the Joint Venture received from the Bank of China, not Kowin, in connection with the Joint Venture). (App. 10-11) However, the Seventh Circuit affirmed the entire award of twenty years of future lost profits. (App. 11)

First, the Seventh Circuit upheld Respondent's award of five-year lost profits:

> We have set out above the circumstances in which we are empowered to set aside an arbitration award. 9 U.S.C. § 10. Insufficiency of the evidence is not one of those grounds and we see no reason to adopt it as such here. In fairness to the arbitrator, even if we could vacate the award we would not do so because the evidence was clearly sufficient to support the award. Kowin's claim for lost profits was based on Eljer's own representations about the venture's profitability and based on Eljer's commitment to purchase a certain number of files every year. (App. 10)

Second, ignoring established authority from other circuits, the Court of Appeals then concluded it had no authority to review the sufficiency of the evidence for the fifteen-year extrapolation of future lost profits:

> For identical reasons, we reject Eljer's request that we limit the award to profits over five years instead of the twenty year term of the contract. The evidence submitted to the arbitrator projected profits for the first five years of the joint venture. Kowin arrived at the figure it requested by extrapolating those profits over the twenty year term of the contract. Eljer asserts that this extrapolation was insufficient to sustain the lost profits award. A question as to the sufficiency of the evidence before the arbitrator simply does not trigger the review powers of this court. For all of the foregoing reasons, we affirm the arbitrator's award of lost profits. (App. 10)

The Seventh Circuit affirmed the fifteen-year extrapolation without citation to any legal authority and without any scrutiny of the sufficiency of its factual base. Eljer asks this Court to review this holding.

Subsequently, Eljer timely filed a motion for reconsideration with suggestion for rehearing *en banc*. The Seventh Circuit denied that motion on March 4, 1994. (App. 15)

REASONS FOR GRANTING THE WRIT

As numerous Circuits have acknowledged, federal courts articulate different standards of review to vacate arbitration awards, even though review is granted pursuant to the same federal statute—the Federal Arbitration Act.[3]

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[3] *See, e.g., McIlroy v. Painewebber, Inc.*, 989 F.2d 817, 820 & n.2 (5th Cir. 1993) (recognizing that other jurisdictions have vacated arbitration awards for "manifest disregard of the law" or where the award is "completely irrational" or "unfounded in reason and fact,"); *Advest, Inc. v. McCarthy*, 914 F.2d 6, 9 & n.6 (1st Cir. 1990) (describing standard of judicial review formulations, in-

(Footnote continued on following page)

The Seventh Circuit has now exacerbated this confusion by barring challenges to the sufficiency of the evidence of arbitration decisions and sustaining a huge damages award for which there was no evidence. This holding conflicts with decisions from the Second, Third, Sixth, and Ninth Circuits, which permit such review. Indeed, the Third and Sixth Circuits have vacated awards based on no evidence.

The Seventh Circuit's holding, and the split in the Circuits, are significant both on legal and policy grounds. Legally, the scope of judicial review affects the outcome of arbitrations, and arbitration outcomes should not depend on the fortuity of the court providing judicial review (which typically depends on where the arbitration proceedings happen to take place). As a matter of policy, the Seventh Circuit's decision will significantly influence parties' decisions whether to use the arbitral forum at all. Under the Seventh Circuit's standard, courts will uphold unpredictable and baseless arbitration awards. As a practical matter, this increased unpredictability and elevated risk of exposure will decrease parties' use of arbitration and increase reliance on the courts to decide their disputes.

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[3] *continued*
cluding "arbitrary and capricious," "manifest disregard of the law," "completely irrational," "essence" of the agreement, and "unfounded in reason and fact"); *Jenkins v. Prudential-Bache Securities*, 847 F.2d 631, 634 (10th Cir. 1988) (describing judicial review as a "sort of 'abuse of discretion' standard," with alternative limitations, including "manifest disregard of the law," "rational basis," and "essence of the contract"); *Shearson Hayden Stone, Inc. v. Liang*, 653 F.2d 310, 312 (7th Cir. 1981) (recognizing that other circuits have suggested awards may be vacated if they are "completely irrational"); *National Railroad Passenger Corp. v. Chesapeake & O.R. Co.*, 551 F. 2d 136, 142 (7th Cir. 1977) (same).

The Seventh Circuit's judgment is also inconsistent with longstanding principles governing the law of arbitration as set forth in § 10(a)(4) of the Federal Arbitration Act, 9 U.S.C. § 10(a)(4), and contrary to the fundamental precept that arbitrators' awards must be based on the contract and submissions of the parties.

Recent decisions of this Court, which have emphasized the liberal federal policy in favor of arbitration and expanded the scope of arbitrable disputes, heighten the importance of this case. This Court should use this opportunity to provide guidance to the federal courts and those parties deciding whether to arbitrate their disputes or resolve them in the courts. Without such review, this Circuit split—and its real effect on the outcomes of arbitrations—will deepen.

I.

THIS COURT SHOULD REVIEW THE SEVENTH CIRCUIT'S JUDGMENT BARRING REVIEW OF ARBITRATION AWARDS FOR SUFFICIENCY OF THE EVIDENCE BECAUSE IT CONFLICTS WITH DECISIONS FROM OTHER CIRCUITS.

At issue here is whether the Federal Arbitration Act requires that arbitration awards be based on *any* evidence. In this case, there was *no* evidence at all for the arbitrator's extrapolation of future lost profit damages. Yet, the Seventh Circuit held—without citation to any authority—that questions concerning sufficiency of the evidence underlying an arbitrator's decision do not trigger appellate review.

Contrary to the Seventh Circuit's decision in this case, the Second, Third, Sixth, and Ninth Circuits permit courts to examine arbitration awards to determine whether the award is based on any evidence in the record or, for its

corollary, whether the award has a rational basis.[4] As opposed to the Seventh Circuit, which seemed to consider factual sufficiency a ground independent of the Act, other courts have reviewed the factual sufficiency of awards to determine whether arbitrators have complied with the Act's provisions and the basic principles that arbitrators not exceed their authority and that awards be based on the contract between and submissions of the parties, while other courts have applied the fundamental evidentiary principle that a damage award must be based on competent evidence in the record.[5]

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[4] In analogous contexts, this Court has suggested that irrational arbitration awards should not be sustained. In *Wilko v. Swan*, 346 U.S. 427, 436-47 (1953), *overruled on other grounds*, 490 U.S. 477 (1989), this Court laid the foundation for the manifest disregard of the law doctrine, which lower courts have interpreted to mean a willful failure to apply governing law. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933 (2d Cir. 1986). This could be considered a form of legal irrationality. Moreover, in upholding an arbitration rendered under the Railway Labor Act, this Court observed that the decision was not "wholly baseless and completely without reason." *See Gunther v. San Diego & A.E.R. Co.*, 382 U.S. 257, 261 (1965). Both cases suggest that irrational arbitration decisions should not stand.

[5] The Seventh Circuit's judgment contributes to the existing disarray in the Circuits regarding the standard of review of arbitration decisions under the Federal Arbitration Act, which heightens the need for guidance by this Court. Not only do the courts use different standards to review arbitration awards under the Act, but also courts reviewing arbitrations may use the same terms to mean different things. For example, some courts use the term "irrational" to mean awards with an irrational legal basis, as opposed to awards which are irrational on the facts. *Compare, e.g., Raiford v. Merrill Lynch, Pierce, Fenner & Smith*, 903 F.2d 1410, 1413 (11th Cir. 1990) (legal irrationality) with *Detroit Coil Co. v. Int'l Ass'n of Machinists*, 594 F.2d 575, 579-81 (6th Cir.), *cert. denied*, 444 U.S. 840 (1979) (factual irrationality). The Second, Third, Sixth, and Ninth Circuits decisions discussed above all concern factual irrationality. Some courts consider irrationality or ar-

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[5] *continued*

bitrariness as non-statutory bases for review, while others deem such grounds as adjunct to § 10(d) of the Act or inherent to judicial review. *Compare, e.g., Stroh Container Co. v. Delphi Industries, Inc.*, 783 F.2d 743, 749-50 (8th Cir.), *cert. denied*, 476 U.S. 1141 (1986) (grounds are non-statutory) with *Jenkins v. Prudential-Bache Securities, Inc.*, 847 F.2d 631, 633-34 (10th Cir. 1988) (grounds are inherent to judicial review or broad interpretation of former § 10(a)(4)).

Overall, the Circuits employ different standards to review awards under § 10. For example, the Fifth Circuit recently held that § 10 of the Act provides the only grounds upon which a court may vacate an award, and declined to adopt standards such as "manifest disregard of the law," "completely irrational," or "unfounded in reason and fact." *McIlroy v. Painewebber, Inc.*, 989 F.2d 817, 820 & n.2 (5th Cir. 1993).

In contrast, in addition to the enumerated statutory standards, the Eleventh Circuit will vacate an award if it is "arbitrary and capricious," but does not recognize the manifest disregard of the law standard. *Brown v. Rauscher Pierce Refsnes, Inc.*, 994 F.2d 775, 779 (11th Cir. 1993). To determine whether an award may be challenged on non-statutory bases in addition to statutory grounds, the Circuit applies a complicated procedural framework involving an abuse of discretion standard. *See id.* at 779. An arbitrary and capricious award exhibits a wholesale departure from the law, is irrational, or is one in which "a ground for the arbitrator's decision can[not] be inferred from the facts of the case." *Id.* at 781. Overall, the circuit reviews denials of motions to vacate arbitration awards for abuse of discretion and reviews grantings of such motions *de novo*.

Different still is the Tenth Circuit, which has described judicial review under the Act as a "sort of 'abuse of discretion' standard." *Jenkins*, 847 F.2d at 634. The Circuit has explicitly adopted the "construction of the contract" analysis set forth in *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960), in both labor and commercial cases. *Id.* at 634-35.

Within the past year alone, the Eighth Circuit has used varying formulations to describe the Act's standard of review. *Compare DVC-JPW Investors v. Gershman*, 5 F.3d 1172, 1174 (8th Cir. 1993) (judicial review limited to statutory grounds) with *Executive Life Insurance v. Alexander Insurance Ltd.*, 999 F.2d 318, 320 (8th Cir. 1993) ("essence from the contract" standard) with *Lee v. Chica*, 983 F.2d 883, 885 (8th Cir.), *cert. denied*, 114 S.Ct. (1993)

(Footnote continued on following page)

In the leading case of *Swift Industries, Inc. v. Botany Industries, Inc.*, 466 F.2d 1125, 1130-31 & n.11, 1134-45 (3d Cir. 1972), the Third Circuit affirmed the vacation of a "completely irrational" arbitration award, in which the arbitrator awarded a six million dollar surety bond when the parties' maximum proportionate liability to be secured by the bond was $1.5 million. The *Swift* Court held that the principles concerning rationality were consistent with the provisions of former § 10(d) of the Act. *See id.* at 1130-31 & n.11. The court concluded it was "capricious" for the arbitrator to fail to investigate and consider the financial situation before making the $6 million award. *See also Mutual Fire, Marine & Inland Ins. Co. v. Norad Reinsurance*, 868 F.2d 52, 57 (3d Cir. 1989) (award can be vacated if terms are completely irrational); *McLaughlin, Piven, Vogel, Inc. v. Gross*, 699 F. Supp. 55, 58 (E.D. Pa.), *aff'd*, 862 F.2d 308 (3d Cir. 1988) (same).

In the labor context as well, the Third Circuit has recognized that arbitration awards must be grounded in some evidence. A court may vacate an arbitration award "if an examination of the record before the arbitrator reveals no support whatever for his determinations." *NF&M*

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[5] *continued*

(well-settled that review is limited to "completely irrational" and "manifest disregard for the law" standards). *See also Stroh Container*, 783 F.2d at 749-50 (enumerating, but declining to adopt non-statutory standards, such as "completely irrational" and "manifest disregard of the law").

The First Circuit has observed that "[t]his standard of judicial review has taken on various hues and colorations in its formulations in this, and other circuits." *Advest, Inc. v. McCarthy*, 914 F.2d 6, 9 (1st Cir. 1990).

Only this Court can allay the increased confusion regarding the proper standard of review that the Seventh Circuit's judgment will fuel.

Corp. v. United Steelworkers of America, 524 F.2d 756, 760 (3d Cir. 1975); *see also, e.g., United Industrial Workers v. Government of the Virgin Islands*, 987 F.2d 162, 170 (3d Cir. 1993) (same); *Tanoma Mining Co. v. Local Union No. 1269*, 896 F.2d 745, 748 (3d Cir. 1990) (same).

The Sixth Circuit is in accord. In *Storer Broadcasting v. American Federation of Television & Radio Artists*, 600 F.2d 45, 47-49 & n.10 (6th Cir. 1979), *cert. denied*, 454 U.S. 1099 (1981), the Sixth Circuit invoked § 10 of the Act and reversed the district court with instructions to vacate an arbitrator's award which had no evidentiary support:

> "although a court is precluded from overturning an award for errors in the determination of factual issues, 'nevertheless, if an examination of the record before the arbitrator reveals no support whatever for his determinations, his award must be vacated.' "

Id. at 47 (quoting *Detroit Coil Co. v. Int'l Ass'n of Machinists*, 594 F.2d 575, 580-81 (6th Cir.), *cert. denied*, 444 U.S. 840 (1979)). In *Detroit Coil*, an action brought under 29 U.S.C. § 185 and former § 10(d) of the Act, the Sixth Circuit ordered an arbitration award set aside because the record contained no evidence allowing the arbitrator to conclude the parties had waived compliance with a certain contractual provision. The court held that this lack of evidence demonstrated that the award could not be rationally deduced from the agreement, nor did it draw its essence from the agreement. *See also Industrial Mutual Ass'n v. Amalgamated Workers, Local Union No. 383*, 725 F.2d 406, 411-412 (6th Cir. 1984) (remanding portion of arbitration award cancelling debts certain reinstated employees owed employer, purportedly in lieu of back pay, because there was no evidentiary basis showing the relationship between back pay and the debts).

Similarly, in the Second Circuit, a court can examine an award's basis if it believes, *inter alia*, the facts of the case fail to support the award. *See Siegel v. Titan Industrial Corp.*, 779 F.2d 891, 894 (2d Cir. 1985). *See also In re Arbitration No. AAA13-161-0511-85 under Grain Arbitration Rules*, 867 F.2d 130, 135 (2d Cir. 1989); *Koch Oil, S.A. v. Transocean Gulf Oil Co.*, 751 F.2d 551, 554 (2d Cir. 1985). In *Siegel*, the Second Circuit reviewed the evidentiary base of an arbitrator's lump sum award to determine whether the arbitrator had correctly applied a generally accepted accounting principle in valuing certain shares of stock. *Id.* at 894-95. *See also, e.g., Fine v. Bear, Stearns & Co.*, 765 F. Supp. 824, 828 (S.D.N.Y. 1991) (holding that award may be vacated if it lacks any factual support); *Collins & Aikman Floor Coverings Corp. v. Froelich*, 736 F. Supp. 480, 487 (S.D.N.Y. 1990) (vacating award of damages as irrational under former § 10(d) of the Act when proof did not support award); *Clemons v. Dean Witter Reynolds, Inc.*, 708 F. Supp. 62, 63-64 (S.D.N.Y. 1989) (remanding award due to serious question whether damages awarded were sustainable on evidence presented before arbitrators); *Concourse Beauty School, Inc. v. Polakov*, 685 F. Supp. 1311, 1319-20 & n.2 (S.D.N.Y. 1988) (deferring to arbitrators' decision because award was "amply supported by evidence in the record," indicating awards should not be sustained where damages have no relation to harm suffered).

In the Ninth Circuit, courts are empowered under the Act to set aside arbitration awards which are "completely irrational." *French v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 784 F.2d 902, 906 (9th Cir. 1986); *see Pacific Reinsurance Management Corp. v. Ohio Reinsurance Corp.*, 935 F.2d 1019, 1025-26 (9th Cir. 1991) (reviewing arbitration decision for "manifest disregard of the facts"). In

French, the Ninth Circuit reviewed a challenge to an arbitrator's award of compensatory damages for a broker's negligent misrepresentation. 784 F.2d at 903-04. Liability was predicated upon a finding that the broker had misstated a material fact. *Id.* The Ninth Circuit reviewed the sufficiency of the evidence relating to the arbitrator's determination of materiality, concluding the award was "adequately supported by the record." *Id.* at 906-07.

As illustrated above, the conflict created between the Seventh Circuit judgment and the Second, Third, Sixth, and Ninth Circuits is real and direct. Had this case been reviewed in another circuit, the evidentiary base of the lost profits' extrapolation would have been scrutinized for sufficiency or rationality. The outcome would likely have been different because there is no evidence in the record for the fifteen-year extrapolation of future lost profits. Absent review by this Court, the split in the Circuits will continue unabated, further aggravating confusion regarding the standard of review. This Court should review the judgment of the Seventh Circuit to ensure uniformity in this area of the law.

II.

THIS COURT SHOULD REVIEW THE JUDGMENT OF THE SEVENTH CIRCUIT BECAUSE THE JUDGMENT WILL UNDERMINE CONFIDENCE IN ARBITRATION AND DISCOURAGE ITS USE.

This Court should also review the judgment of the Seventh Circuit because the judgment will undermine confidence in the arbitration process. In choosing arbitration, parties bargain for an efficient decision based on the arbitrator's review of the issues and evidence submitted. The parties do not bargain for an irrational or unpredictable decision, or a determination based on the arbitrator's own ideas, not grounded in the facts of the case.

Parties will be discouraged from using arbitration if courts sanction irrational awards in which the facts play no part. Parties will not submit their disputes to be determined in a forum where the decisionmaker's discretion is not bounded by rationality or any requirements to adhere to the evidence. *See* Theodore J. St. Antoine, *Judicial Review of Labor Arbitration Awards: A Second Look at Enterprise Wheel and its Progeny*, 75 Mich. L. Rev. 1137, 1149 (1977) (arguing for limited judicial review, but "reluctantly" accepting that irrationality should be ground to set aside awards because parties would assume arbitrator's decisions would not be irrational). Indeed, as one commentator has observed, "[d]espite differences between court litigation and arbitration proceedings, certain common principles of justice must be maintained, and it is in this area that court intervention in the arbitration process plays an important role." 1 Gabriel M. Wilner, *Domke on Commercial Arbitration* § 1.01, at 2-3 (rev. ed. 1993).

Despite these concerns, the Seventh Circuit held that it would not scrutinize awards for sufficiency of the evidence—or any evidence. With this case as a published precedent, parties who arbitrate their disputes in that circuit will be subject to decisions, such as the one sustained here, which are founded on no evidence at all. This increased risk that awards will not be based on the parties' submissions—and the heightened unpredictability in arbitration outcomes—will decrease confidence in the arbitration process, resulting in less frequent use of that forum. *See* Note, *Commercial Arbitration: Expanding the Judicial Role*, 52 Minn. L. Rev. 1218, 1238 (1968) (most significant objection to arbitration is its unpredictability, which has led some executives to distrust and therefore avoid the process). In turn, less frequent use of arbitration to

resolve disputes will bring additional parties into the courts.

This Court should review the judgment of the Seventh Circuit to maintain parties' confidence in, and use of, the arbitral forum as an alternative to the courts.

III.

THIS COURT SHOULD REVIEW THE JUDGMENT OF THE SEVENTH CIRCUIT BECAUSE IT IS INCONSISTENT WITH THE POLICY THAT ARBITRATION AWARDS MUST BE BASED ON THE CONTRACT BETWEEN THE PARTIES AND VITIATES SECTION 10(a)(4) OF THE ACT.

This Court should also review the Seventh Circuit's judgment because it is inconsistent with the principle underlying the arbitration process that decisions must be rendered from the agreement between the parties. The judgment also vitiates Section 10(a)(4) of the Act.

As this Court recently held, "the arbitrator's award settling a dispute with respect to the interpretation or application of a labor agreement must draw its essence from the contract and cannot simply reflect the arbitrator's own notions of industrial justice." *United Paperworkers International Union v. Misco, Inc.*, 484 U.S. 29, 38 (1987). Courts have repeatedly applied these principles in arbitrations under the Act as well. *See, e.g., Executive Life Insurance Co.*, 999 F.2d at 320; *Jenkins v. Prudential-Bache Securities*, 847 F.2d at 634; *Coast Trading Co. v. Pacific Molasses Co.*, 681 F.2d 1195, 1197 (9th Cir. 1982); *Swift Industries*, 466 F.2d at 1129-31. The "essence of the contract" analysis is consistent with § 10(a)(4) of the Act, which empowers a court to vacate an arbitration "[w]here the arbitrators exceeded their powers, or so imperfectly executed them that mutual, final and definite

award upon the subject matter submitted was not made." 9 U.S.C. § 10(a)(4).

Many courts have recognized that arbitrators' awards must be scrutinized for factual sufficiency to ensure that decisions are based on the parties' contract and submissions, and not based on an arbitrator's extraneous notions or private views. *See, e.g., Storer*, 600 F.2d at 47-49 (vacating arbitration award not based on record evidence, noting arbitrator dispensed his own brand of justice); *see also Shearson Loeb Rhoades Inc. v. Much*, No. 81-4225 at 8-9 (N.D. Ill., Jan. 3, 1983) (directing rehearing on damages when award was based on "sheer speculation" and was without record support), *appeal dismissed*, 754 F.2d 773 (7th Cir. 1985).

The issue here is not *de novo* review, with all its burdens; the only issue is whether arbitration awards must be based on *some* evidence. Assessment for evidentiary sufficiency merely ensures that arbitrators make decisions on the basis of the agreement and evidence submitted, and not on sheer speculation or the arbitrator's private views. This Court should review the judgment of the Seventh Circuit to ensure it does not erode essential policies underlying the system of arbitration or undermine Section 10(a)(4) of the Federal Arbitration Act.[6]

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[6] In determining whether disputes brought under the Securities Exchange Act of 1934 are arbitrable, this Court noted, in relation to whether arbitrators would follow the law, that "although judicial scrutiny of arbitration awards necessarily is limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute." *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 232 (1987); *see also Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991). Neither *Shearson* nor *Gilmer* concerned whether arbitration awards must be grounded in sufficient evidence. However, to paraphrase those cases, should courts not review arbitrators' decisions for sufficiency of the evidence, judicial scrutiny will not be adequate to ensure that arbitrators decide the merits of the parties' controversies, instead of applying their own notions of justice.

CONCLUSION

For all the foregoing reasons, this Court should grant this petition for certiorari.

Respectfully submitted,

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Dated: April 18, 1994

APPENDIX

IN THE
UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Nos. 93-1539, 93-1607

IN THE MATTER OF THE ARBITRATION BETWEEN:
ELJER MANUFACTURING, INCORPORATED, formerly known as HOUSEHOLD MANUFACTURING, INCORPORATED,

Petitioner-Appellant,
Cross-Appellee,

v.

KOWIN DEVELOPMENT CORPORATION,

Respondent-Appellee,
Cross-Appellant.

Appeals from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 92 C 7250—**James B. Moran**, *Chief Judge.*

ARGUED OCTOBER 26, 1993—DECIDED JANUARY 31, 1994

Before BAUER and COFFEY, *Circuit Judges*, and SKINNER, *District Judge.**

BAUER, *Circuit Judge.* Eljer Manufacturing, Inc., seeks to modify an arbitration order entered against it. The district court reduced part of the award and affirmed the

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* The Honorable Walter Jay Skinner, United States District Judge for the District of Massachusetts, is sitting by designation.

remainder. Kowin Development Corp. cross-appeals, arguing that the district court's reduction of the award should be reversed and the order of the arbitrator reinstated in full. We affirm in part and modify the award in part.

I. Facts

Eljer was, during the relevant period, the parent corporation of the Simonds Division, a producer of metal files. In 1984, Simonds along with Kowin formed Kowin-Simonds, Inc. The agreement creating Kowin-Simonds provided that Kowin-Simonds would participate in a joint venture with a Chinese company to manufacture files in China. The Chinese joint venture would then agree to supply Simonds with a certain proportion of Simonds's file requirements every year for twenty years. Kowin and Simonds agreed to submit any disputes arising under the agreement to arbitration.[1]

To aid the Chinese joint venture, Simonds agreed to sell its excess manufacturing equipment for a total price of $3.5 million. Kowin-Simonds bought some of this equipment with the proceeds of a $2.5 million loan from the Bank of America. Kowin and Eljer each guaranteed $1.25 million of the loan. The rest of the necessary equipment was purchased for $1 million by the Bank of China which in turn leased the equipment back to the Chinese joint venture. Pursuant to the Kowin-Simonds agreement, Simonds paid Kowin a $500,000 commission which the arbitrator determined to be in return for arranging all the financing.

In June of 1985, the Beijing Steel Files Plant agreed to be Kowin-Simonds's Chinese partner in the joint ven-

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[1] The arbitration clause states:

> In the event any dispute shall arise pursuant to this agreement or should the board of directors be deadlocked, then the dispute shall be resolved by arbitration pursuant to the rules of the American Arbitration Association.

ture and operations began soon thereafter. For a variety of reasons, not relevant for purposes of our review, the venture failed miserably. As a result of the failure, Kowin-Simonds was unable to meet its obligations on the Bank of America loan and, as guarantors, Eljer and Kowin were each forced to pay the bank $1.25 million plus accrued interest.

On March 17, 1988, Kowin sued Eljer and Simonds in the United States District Court for the Central District of California. Kowin's complaint listed fraud, breach of contract, and federal securities claims,[2] and alleged that Eljer and Simonds fraudulently misrepresented and concealed facts concerning the equipment it sold and the market conditions for steel files.

Eljer moved to compel arbitration pursuant to the Kowin-Simonds agreement and the district court granted the motion. The parties proceeded to arbitration in Chicago, and on October 30, 1992, the arbitrator awarded Kowin a total of $14,844,858 in damages, $4 million in prejudgment interest and attorneys' fees. The arbitrator divided the damages into three separate awards: (1) $2,960,542; (2) $8,384,316; and (3) $3,500,000. The arbitrator neglected, however, to articulate his findings any further. Eljer filed a motion to vacate or modify the award in the United States District Court for the Northern District of Illinois.

On March 1, 1993, the district court partially affirmed the arbitrator's award. Because each award duplicated precisely the amounts requested by Kowin in the damages section of its post-hearing brief, the court was easily able to determine what injury each of the three damage awards was intended to compensate. Once it had discerned the bases for each award, the court reduced two of the three awards.

The first award of $2,960,542 represented the $2.5 million principal of the Kowin-Simonds loan plus $460,542 of

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[2] Kowin later added a claim arising under Illinois securities laws.

accrued interest.[3] As guarantor on $1.25 million of the loan, Eljer had already paid this sum to the bank. Including this in the award would have required Eljer to make the same payment twice. The district court, therefore, reduced this award by $1.25 million.

The arbitrator's second damages award of $8,384,316 represented lost profits projected over the twenty year term of the contract plus Kowin's $250 capital contribution to the venture. The district court refused to modify this award because in its view the arbitrator did not deliberately disregard the law.

As for the third award of $3.5 million, the court concluded it represented what Kowin alleged to be Simonds's unjust enrichment from the sale of its equipment. Recognizing that $2.5 million of this, the Bank of America proceeds, was included in the first award, the court reduced the award to $1 million to avoid double recovery.

II. Standard of Review

Our scope of review of a commercial arbitration award is grudgingly narrow. Sections 10 and 11 of the Federal Arbitration Act provide statutory grounds for the modification of an arbitrator's decision.[4] In addition to the rea-

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[3] This figure represents solely the interest accrued on Kowin's portion of the loan. The interest accrued on Eljer's portion was excluded by Kowin in its brief.

[4] The relevant portion of § 10 reads as follows:

> (a) In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
>
> (4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a)(4).

(Footnote continued on following page)

sons set out in the statute, we will set aside an arbitrator's decision if in reaching his result, the arbitrator deliberately disregards what he knows to be the law. *Health Servs. Mgmt. Corp. v. Hughes*, 975 F.2d 1253, 1267 (7th Cir. 1992). Errors in the arbitrator's interpretation of law or findings of fact do not merit reversal under this standard. *National Wrecking Co. v. International Brotherhood of Teamsters, Local 731*, 990 F.2d 957 (7th Cir. 1993); *Moseley, Hallgarten, Estabrook, & Weeden v. Ellis*, 849 F.2d 264 (7th Cir. 1988). Nor does an insufficiency of evidence supporting the decision permit us to disturb the arbitrator's order. Arbitration does not provide a system of "junior varsity trial courts" offering the losing party complete and rigorous *de novo* review. *National Wrecking*, 990 F.2d at 960. It is a private system of justice offering benefits of reduced delay and expense. A restrictive standard of review is necessary to preserve these benefits and to prevent arbitration from becoming a "preliminary step to judicial resolution." *E.I. DuPont de Nemours v. Grasselli Employees Indep. Ass'n*, 790 F.2d 611, 614 (7th Cir.), *cert. denied*, 479 U.S. 853 (1986).

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[4] *continued*

The relevant portions of § 11 read as follows:

> In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon application of any party to the arbitration—
>
> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing, or property referred to in the award.
>
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.
>
> The order may modify and correct the award, so as to effect the intent thereof and promote justice between the parties.

9 U.S.C. § 11(a), (c).

III. Kowin's Cross-Appeal

We deal first with the cross-appeal. Kowin argues that the court's reduction of the award rests on impermissible speculation as to what each of the arbitrator's three awards was attempting to redress. We disagree. Kowin confuses a narrow standard of review with a nonexistent standard of review. The basis for each of the arbitrator's awards is no mystery. As the district court noted, the figures were identical to certain amounts requested by Kowin in the damages section of its post-hearing brief. It was hardly speculative for the district court to base its analysis on Kowin's own explanation of its damages. We agree with the district court's breakdown of the awards and its subsequent review in that light.

We also agree with the district court's reduction of the first and third award. When an arbitration award orders a party to pay damages that have already been paid or which are included elsewhere in the award, a court may modify the award. Double recovery constitutes a materially unjust miscalculation which may be modified under section 11 of the Federal Arbitration Act. *Transnitro, Inc. v. M/V Wave*, 943 F.2d 471 (4th Cir. 1991); *Ellis*, 849 F.2d at 272.

IV. Eljer's Appeal

Eljer attacks three aspects of the arbitrator's award. First, Eljer argues that the arbitrator's failure to explain the basis for his award requires that we remand the case to him with instructions to clarify the grounds for the award. Second, Eljer claims that the arbitrator made several miscalculations in his damage awards. Third, Eljer contends that the arbitrator's award of attorneys' fees was improper. We consider these arguments in turn.

A. Arbitrator's Failure to Explain the Award

Eljer argues that the arbitrator's failure to articulate the grounds for his award prevented "meaningful judicial

review" of his claim. Eljer's concern is that the arbitrator erroneously rejected some of its defenses and by shielding his decision from scrutiny, prevented reviewing courts from exposing those errors. Eljer asks that we remand the case to the arbitrator with instructions to clarify his award.

This argument fails for two reasons. First and most fundamentally, an arbitrator is simply not required to state the reasons for his decision. *Randall v. Lodge No. 1076, Int'l Ass'n of Machinists and Aerospace Workers*, 648 F.2d 462, 468 (7th Cir. 1981). Such a requirement would serve only to perpetuate the delay and expense which arbitration is meant to combat.

Eljer's requested remand must also be denied because errors of law alone do not constitute a sufficient basis for remanding the case. In its brief, Eljer goes to great lengths in trying to persuade us that various legal defenses it presented to the arbitrator should have prevailed. Eljer misses the point. Even if its legal defenses were dispositive, the fact that the arbitrator erroneously rejected them does not, by itself, provide grounds for a remand. The arbitrator must have deliberately disregarded what he knew to be the law. Eljer has not shown such disregard here.

B. Damage Awards

Eljer challenges the arbitrator's three awards, alleging that each contains flaws in its calculation. Claiming that the cumulative award constitutes a triple recovery, Eljer also contests the award as a whole.

1. Award of $1,710,542. Eljer's objection to the first award is that even after the reduction by the district court, the award exceeds Kowin's damages by $500,000. As it stands, this award is comprised of the principal and interest on Kowin's share of its guarantee on the Bank of America loan.

In the Letter of Intent which was later incorporated into the Kowin-Simonds agreement, the parties agreed that Kowin would receive a $500,000 commission. The par-

ties dispute however for what service that commission was to be paid. Eljer claims that the commission was paid to Kowin in exchange for entering into the venture. Eljer insists that the commission must be offset against the damages incurred by Kowin in making its loan payment.

Not surprisingly, Kowin disputes this explanation for the commission. According to Kowin, the commission was compensation for Kowin's role in arranging the financing necessary to purchase Simonds's machinery and not as an inducement to enter the transaction. From this perspective, the commission was in essence a separate agreement and should not impact the damages Kowin suffered from having to satisfy Kowin-Simonds's loan.

We refuse to reduce this award further. Eljer's argument merely asserts that the arbitrator reached the wrong result from conflicting evidence. Our scope of review does not permit us to disturb the arbitrator's findings as to the relative credibilities of each side's evidence. We therefore yield to the decision of the arbitrator.

2. Award of $8,384,316. This award represented Kowin's share of the profits which Eljer projected the joint venture would generate in its first five years, extrapolated over the twenty year term of the contract. Eljer advances three theories for vacating or reducing this award. First, Eljer contends the award should be vacated because under the relevant law, future lost profits are not recoverable. Second, Eljer requests that we vacate the award because it was based on insufficient evidence. Alternatively, Eljer asks us to limit the award to profits projected over the first five years and to vacate the portion of the award which represents the extrapolation over the remaining fifteen years. Eljer claims that this extrapolation is too tenuous on which to base an award.

Eljer's first claim essentially asks us to vacate the award because the arbitrator made an error of law. Kowin asserted violations of federal securities laws as well as California and Illinois tort law. Since federal securities law does not permit the recovery of future lost profits, *Madigan, Inc. v. Goodman*, 498 F.2d 233, 239 (7th Cir. 1974),

Eljer reasons that the award could only have been granted pursuant to the California and/or Illinois claims. Neither California nor Illinois law, however, permit awards of lost profits to "unestablished" ventures because profit projections are usually too speculative. *Maggio, Inc. v. United Farm Workers of America*, 278 Cal. Rptr. 250, 264 (Cal. App. 1991); *Drs. Sellke & Conlon v. Twin Oaks Realty*, 491 N.E.2d 912, 917 (Ill. App. 1986). Eljer concludes that because the arbitrator's second award was barred by the applicable law, the arbitrator exceeded his powers under section 10(a)(4) of the Federal Arbitration Act.

Contrary to Eljer's reading, a court can modify an arbitrator's decision under section 10(a)(4) only if the arbitrator exceeds the powers delegated to him by the parties. *Ethyl Corp. v. United Steelworkers of America*, 768 F.2d 180, 184 (7th Cir. 1985). In this case, whether or not the claim is permitted under the applicable law is irrelevant under 10(a)(4). Nor can we hold that the arbitrator's award was in deliberate disregard of the law. As we have stated repeatedly, mere error in the interpretation of the law (as opposed to failure to decide in accordance with relevant provisions of law) does not provide grounds for disturbing an arbitration award. *Health Services*, 975 F.2d at 1267.

Even if an arbitrator's mistake of law permitted us to modify his decision, we still would not do so here. The premise of the so-called "new business" rule is that the success of a new enterprise is ordinarily uncertain. Where, however, the enterprise is simply an absorption or extension of a previously established successful operation and the venture's future is less in doubt, the awarding of future lost profits is not, as a matter of law, forbidden. *GHK Assocs. v. Mayer Group, Inc.*, 274 Cal. Rptr. 168 (Cal. App. 1990); *Hallmark Ins. Admin'rs v. Colonial Penn. Life Ins.*, 697 F. Supp. 319, 327 (N.D. Ill. 1988), *aff'd*, 990 F.2d 984 (7th Cir. 1993). Kowin argued that the Chinese venture fell under this exception and the arbitrator could have made his decision on this basis.

This brings us to Eljer's second argument for vacating the award of lost profits: that the evidence supporting the award was insufficient. We have set out above the circumstances in which we are empowered to set aside an arbitration award. 9 U.S.C. § 10. Insufficiency of the evidence is not one of those grounds and we see no reason to adopt it as such here. In fairness to the arbitrator, even if we could vacate the award we would not do so because the evidence was clearly sufficient to support the award. Kowin's claim for lost profits was based on Eljer's own representations about the venture's profitability and based on Eljer's commitment to purchase a certain number of files every year.

For identical reasons, we reject Eljer's request that we limit the award to profits over five years instead of the twenty year term of the contract. The evidence submitted to the arbitrator projected profits for the first five years of the joint venture. Kowin arrived at the figure it requested by extrapolating those profits over the twenty year term of the contract. Eljer asserts that this extrapolation was insufficient to sustain the lost profits award. A question as to the sufficiency of the evidence before the arbitrator simply does not trigger the review powers of this court. For all of the foregoing reasons, we affirm the arbitrator's award of lost profits.

3. Award of $1,000,000. This award represents the amount by which Eljer was alleged to have been unjustly enriched. The arbitrator originally awarded $3.5 million but the district court reduced the amount after determining that the $2.5 million loan was included in both this award and the first award.

In its reduced form, the award is comprised solely of the fee which Eljer received from the Bank of China for some of Simonds's equipment. The Bank of China has sued Eljer in China for fraud in connection with this sale. Kowin claims that Eljer should be required to disgorge the proceeds of this sale. While we agree that Eljer should not be permitted to benefit from any fraudulent activity, it

is unclear why Eljer should pay Kowin for losses suffered by the Bank of China.

Eljer argues here that the remaining $1 million should be vacated because in awarding Kowin damages for a loss it did not suffer, the arbitrator exceeded his powers under the contract. We agree. The test for vacating an award under section 10(a)(4) of the Arbitration Act is whether the arbitrator exceeded the powers delegated to him by the parties. *Ethyl Corp.*, 768 F.2d at 184. Though the arbitration clause is broadly worded, it cannot be construed to delegate to the arbitrator the power to arbitrate disputes between Eljer and a third party. The language of the clause limits arbitration to disputes arising under the contract. The transaction between the Bank of China and Eljer was completely separate from the Kowin-Simonds agreement and was therefore outside the scope of the arbitration clause. Because the arbitrator exceeded the scope of his powers, we vacate the third damage award of $1 million.

4. The damage award as a whole. Eljer asserts that the most significant miscalculation by the arbitrator was his granting of three separate measures of damages. Eljer claims that the award as a whole gave Kowin a triple recovery and asks that we modify the awards so that Kowin is granted only one measure of damages. Although we have already vacated the third award, we presume that Eljer's objection still stands with respect to the two remaining awards.

Eljer errs in characterizing the two awards as alternative measures of Kowin's damages. Each award represents a separate and distinct injury which Kowin suffered as a result of Eljer's actions. The first award compensates Kowin for having to pay off a loan that otherwise would have been paid by Kowin-Simonds. The second award gives Kowin the benefit of the bargain which Kowin would have realized had Eljer not breached the contract. The two awards are not incompatible. We therefore affirm the arbitrator's granting of the two awards.

C. Attorneys' Fees

Apparently in reliance on the "American Rule" for attorneys' fees, Eljer submits that in arbitration, as in court, each side must pay its own legal expenses absent an express statutory or contractual provision to the contrary. Eljer argues that in this case the arbitrator had no statutory or contractual basis for awarding Kowin attorneys' fees and requests that we vacate the award. We find otherwise and affirm the arbitrator's decision.

At the outset, we point out that at least one other jurisdiction has rejected extension of the "American Rule" to arbitration. *Tennessee Dep't of Human Servs. v. United States Dep't of Educ.*, 979 F.2d 1162, 1169 (6th Cir. 1992). We need not decide whether such an approach is merited in this circuit because we find that the arbitrator's award was within his authority. First, as Eljer acknowledges, Kowin's Illinois securities law claim, if successful, permits recovery of attorneys' fees. 815 ILCS § 5/13(2) (1993). This claim was submitted to the arbitrator for resolution pursuant to the arbitration clause as a claim arising under the terms of the contract. In passing on this claim, the arbitrator was well within his powers to award attorneys' fees.

Eljer argues in rebuttal that the arbitrator could not have awarded fees pursuant to Illinois securities law because those claims were time barred. Once again, Eljer attempts to have us review the arbitrator's decision for errors in law. We emphasize yet again that on factual and legal questions falling within the arbitrator's authority, we defer to his decision.

The arbitrator's decision could have been based on other state law as well. It is completely possible that the arbitrator awarded attorneys' fees as damages for fraud or misrepresentation and not pursuant to a statute. Illinois law permits the recovery of attorneys' fees as damages if the plaintiff proves that the fees resulted from the defendant's misconduct and the fees are reasonable. *Tan v. Boyke*, 508 N.E.2d 390, 397 (Ill. App. 1987). Attorneys'

fees "may be recovered under the common law as an element of compensatory damages in cases where the defendant's tortious conduct proximately caused the plaintiff to incur them." *Calcagno v. Personalcare Health Mgmt.*, 565 N.E.2d 1330, 1339 (Ill. App. 1991).

V. Conclusion

For the foregoing reasons, we vacate the arbitrator's third award, reducing the total award by $1,000,000. In all other respects, the district court's decision reducing part of the arbitrator's award and enforcing the remainder, is affirmed.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Seventh Circuit

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

JUDGMENT – WITH ORAL ARGUMENT

Date: January 31, 1994

BEFORE:

Honorable WILLIAM J. BAUER, Circuit Judge
Honorable JOHN L. COFFEY, Circuit Judge
Honorable WALTER JAY SKINNER, District Judge*

Nos. 93-1539 & 93-1607

IN THE MATTER OF THE ARBITRATION BETWEEN:

ELJER MANUFACTURING, INCORPORATED,
formerly known as HOUSEHOLD MANUFACTURING,
INCORPORATED,
Petitioner-Appellant, Cross-Appellee

v.

KOWIN DEVELOPMENT CORPORATION,
Respondent-Appellee, Cross-Appellant

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division
No. 92 C 7250—James B. Moran, Chief Judge

The arbitrator's third award, reducing the total award by $1,000,000 is VACATED; in all other respects, the district court's decision reducing part of the arbitrator's award and enforcing the remainder, is AFFIRMED, in accordance with the decision of this court entered on this date. Each party is to bear their own costs.

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* The Honorable Walter Jay Skinner, United States District Judge for the District of Massachusetts, is sitting by designation.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

March 4, 1994.

Before

Hon. WILLIAM J. BAUER, Circuit Judge
Hon. JOHN L. COFFEY, Circuit Judge
Hon. WALTER JAY SKINNER, District Judge*

Nos. 93-1539, 93-1607

In the Matter of the Arbitration Between:
ELJER MANUFACTURING, INCORPORATED, etc.,
Petitioner-Appellant, Cross-Appellee

v.

KOWIN DEVELOPMENT CORPORATION,
Respondent-Appellee, Cross-Appellant

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 92 C 7250—James B. Moran, *Chief Judge.*

ORDER

On consideration of the petition for rehearing with suggestion for rehearing *en banc* filed in the above-captioned case by petitioner-appellant, cross-appellee, all of the judges on the original panel have voted to deny and none of the judges in active service has requested a vote thereon. Therefore, the petition for rehearing with suggestion for rehearing *en banc* is DENIED.

On consideration of the petition for rehearing filed by Kowin Development Corporation, all of the judges on the original panel have voted to deny. The petition for rehearing is DENIED.

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* The Honorable Walter Jay Skinner, United States District Judge for the District of Massachusetts, is sitting by designation.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

March 18, 1994.

Before

Hon. WILLIAM J. BAUER, Circuit Judge

Nos. 93-1539 and 93-1607

IN THE MATTER OF THE ARBITRATION BETWEEN:

ELJER MANUFACTURING, INCORPORATED,
formerly known as HOUSEHOLD MANUFACTURING,
INCORPORATED,
Petitioner-Appellant, Cross-Appellee

v.

KOWIN DEVELOPMENT CORPORATION,
Respondent-Appellee, Cross-Appellant

Appeal from the United States District Court
for the Northern District of Illinois, Eastern Division.
No. 92 C 7250—James B. Moran, Chief Judge.

Upon consideration of:

1. "MOTION TO STAY ISSUANCE OF MANDATE PENDING APPLICATION FOR CERTIORARI" filed on March 10, 1994, by counsel for the petitioner.
2. "APPELLEE AND CROSS-APPELLANT'S OPPOSITION TO MOTION TO STAY ISSUANCE OF MANDATE; DECLARATION OF DOROTHY KO" filed on March 15, 1994, by counsel for respondent.
3. "ORIGINAL SIGNED DECLARATION OF DOROTHY KO IN SUPPORT OF APPELLEE AND CROSS-APPELLANT'S OPPOSITION TO MOTION TO STAY ISSUANCE OF MANDATE" filed on March 16, 1994, by counsel for the respondent.

IT IS ORDERED that the motion is GRANTED and the mandate is STAYED to and including April 18, 1994.

[Dated March 1, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN THE MATTER OF THE ARBITRATION BETWEEN	)	
HOUSEHOLD MANUFACTURING, INC.,	)	No. 92 C 7250
and	)	
KOWIN DEVELOPMENT CORP.	)	

MEMORANDUM AND ORDER

In March 1988, Kowin Development Corporation (Kowin) sued Household Manufacturing, Inc. (Household), now called Eljer Manufacturing, Inc.[1] (Eljer), in a United States District Court in California, alleging fraud and breach of contract in relation to the formation and operation of the joint venture between Kowin-Simonds and the Beijing Steel Files Plant of Beijing, China (the Chinese joint venture). Household invoked an arbitration clause in a contract between Kowin and Household. In December 1989, the California district court stayed the action and ordered arbitra-

[1] Eljer was sued and participated in the arbitration hearing under its former name Household Manufacturing, Inc. Because all of the agreements, activity and briefing occurred when the company was called Household we will refer throughout this opinion to the entity as "Household."

tion. The arbitration hearing was conducted in June 1992, before Joseph Kostner (Kostner). On October 30, 1992, Kostner issued an award in favor of Kowin. Before us now is Household's motion to vacate or modify the arbitration award as permitted in the Federal Arbitration Act, 9 U.S.C. §§10-11, and Kowin's motion to confirm the award. 9 U.S.C. §9. For the reasons stated below, the arbitration award is modified in part and confirmed in part.

FACTS

Our review in this case is confined to determining whether or not the arbitration award should be confirmed. The arbitrator's findings of fact and conclusions with respect to liability have not been challenged and are presumed to be true. Many of the facts are therefore irrelevant and we include here only those that concern the damages award and those that have a direct bearing on our decision.

In 1984, Simonds Cutting Tools, N.A. (Simonds), a division of Household, entered into an agreement with Kowin to form a new corporation, Kowin-Simonds, Inc. (Kowin-Simonds). In turn, Kowin-Simonds entered into a joint venture with the Beijing Steel Files Plant of Beijing, China.

In November 1985, Kowin-Simonds obtained a loan of $2.5 million from the Bank of America (the Kowin-Simonds loan). The Kowin-Simonds loan took the form of two separate notes, each in the amount of $1.25 million. Kowin guaranteed one note (Note A) and Household guaranteed the other note (Note B). The Bank of China also agreed to pay $1 million for certain manufacturing equipment which the Bank of China would lease to the Chinese joint venture.

Simonds received $3.5 million (the $2.5 million Kowin-Simonds loan and $1 million from the Bank of China) for its equipment. Specified equipment was transferred to the Bank of China in return for its $1 million payment, and the bank leased this equipment to the Chinese joint venture. Kowin-Simonds purchased the balance of the equipment from Simonds and contributed the equipment to the Chinese joint venture.

The Chinese joint venture failed to make a profit. After the Kowin-Simonds loan became due Kowin and Household each paid off the principal and interest on their respective notes.

On March 17, 1992, Kowin sued Household and Simonds in the United States District Court for the Central District of California, alleging fraud and breach of contract claims related to the formation and operation of the Chinese joint venture. On December 27, 1989, the district court stayed the lawsuit and ordered arbitration to proceed.[2]

Kostner conducted the arbitration hearing during the week of June 22, 1992. On October 30, 1992, Kostner issued his award. The arbitration award did not identify the cause (or causes) of action upon which Kostner found liability against Household and in favor of Kowin. However, there were three separate award amounts (numbered 1-3). The award in part reads as follows:

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[2] In April 1988, a group of Simonds' management purchased the Simonds' division from Household. The new company, Simonds Industries, Inc. (Simonds Industries), acquired Household's 50% of the Kowin-Simonds shares and assumed the rights and obligations of Household regarding subsequent operations of Kowin-Simonds and the Chinese joint venture.

1. Household shall pay to the Kos[3] as successors-in-interest to [Kowin] the sum of **TWO MILLION NINE HUNDRED SIXTY THOUSAND FIVE HUNDRED FORTY-TWO DOLLARS AND NO CENTS ($2,960,542.00)** plus interest at the rate of 10% per annum subsequent to August 1, 1992.
2. Household shall pay to the Kos as successors-in-interest to [Kowin] the sum of **EIGHT MILLION THREE HUNDRED EIGHTY-FOUR THOUSAND THREE HUNDRED SIXTEEN DOLLARS AND NO CENTS ($8,384,316.00)** with interest at the rate of 10% per annum subsequent to the date hereof.
3. Household shall pay to the Kos as successors-in-interest to [Kowin] the sum of **THREE MILLION FIVE HUNDRED THOUSAND DOLLARS AND NO CENTS ($3,500,000.00)** with interest at the rate of 10% per annum from November 27, 1985.

(emphasis in original). In addition, the arbitrator awarded Kowin attorneys fees.

DISCUSSION

I. Standard of Review

Judicial review of an arbitration award is extremely narrow. *Flender Corporation v. Techna-Quip Co.*, 953 F.2d 273, 278 (7th Cir. 1992); *Moseley, Hallgarten, Estabrook & Weeden v. Ellis*, 849 F.2d 264, 267 (7th Cir. 1988). The Seventh Circuit has held that the exclusive grounds for vacating or modifying an arbitration award are specified by sections 10 and 11 of the Federal Arbitration Act (the Act). *Chameleon Dental Products, Inc. v. Jackson*, 925

[3] On January 31, 1990, the Kos became the successors-in-interest to Kowin. (Household appdx. at 54).

F.2d 223, 226 (7th Cir. 1991). The relevant portions of sections 10 and 11 of the Act read as follows:

> In any of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—
>
> (a)(4) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final and definite award upon the subject matter submitted was not made.

9 U.S.C. §10.

> In either of the following cases the United States court in and for the district wherein the award was made may make an order modifying or correcting the award upon the application of any party to the arbitration—
>
> (a) Where there was an evident material miscalculation of figures or an evident material mistake in the description of any person, thing or property referred to in the award.
>
> * * * *
>
> (c) Where the award is imperfect in matter of form not affecting the merits of the controversy.

9 U.S.C. §11.

Until recently the Seventh Circuit has not applied the "manifest disregard of the law" grounds for attacking an arbitration award. *Chameleon Dental*, 925 F.2d at 226. However, in *Health Services Management Corp. v. Hughes*, 975 F.2d 1253, 1267 (7th Cir. 1992), the court recognized that an arbitration award could be vacated for manifest disregard of the law in limited circumstances where it was shown that there was "something beyond and different than mere error in law or failure on the part of the arbitrator to understand and apply the law; it must be demon-

strated that the majority of the arbitrators deliberately disregarded what they knew to be the law in order to reach the result they did." Therefore, the *Health Services* court narrowly applied the manifest disregard of the law standard for vacating an arbitrator's award—limiting it to those cases where the arbitrator had deliberately disregarded the law.

While the parties go into great detail explaining and discussing the ramifications of *Health Services*, it is not necessary for us to further consider that case. *Health Services* did not stretch the existing precedent very far and, in this case, Household relies primarily on statutory grounds in support of its motion to vacate the arbitrator's award. Therefore, the award may be overturned where the arbitrator deliberately disregarded the law, where there was an evident material miscalculation of figures, where the arbitrator exceeded his or her powers, or as otherwise stated in sections 10 and 11 of the Act.

II. Review of the Arbitrator's Award

Kowin maintains that the arbitrator's award is a "lump sum" award divided into distinct elements in order to assign different interest periods to the various elements. Kowin argues, therefore, that as a matter of law the award is not subject to challenge and is immune from judicial review. Kowin disputes Household's segregation of the award into first, second, and third damage awards. It argues that such a division is pure speculation since it is impossible to determine what the three damage amounts represent or how the arbitrator came up with those three numbers.

We disagree. The award does not provide a lump sum damage amount, but clearly states three damage amounts

that match to the penny the proposed damages set out by Kowin in its post-hearing brief. The damage awards are distinct from each other on the face of the arbitrator's decision, and we can ascertain the specific types of damages to which the amounts correspond by referring to Kowin's post-hearing brief. We therefore review the damage awards individually, in accordance with the standards set forth above in section I.

The first award of $2,960,542 represents the entire principal amount of the Kowin-Simonds loan ($2,500,000) plus interest ($460,542). (Household appdx. at 53). It is undisputed that Household, as guarantor, paid the full principal ($1,250,000) and interest on Note B when the Chinese joint venture failed.[4] This represents half of the $2,500,000 principal balance of the Kowin-Simonds loan. That damage award therefore includes an amount of $1,250,000 that was already paid by Household. Household cannot be required to pay the same amount twice. The first damage award involves an evident and material miscalculation of figures since it includes an amount that Household already paid. The award must therefore be reduced from $2,960,542 to $1,710,542. This adjusted award reflects the principal amount of Note A ($1,250,000) plus the interest on that note ($460,542).

The second award of $8,384,316 represents Kowin's share of future lost profits of the Chinese joint venture

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[4] Kowin does not dispute the fact that Household paid the $1,250,000 note amount and, in fact, in its post-hearing brief states that the $2,960,542 includes the "$1.25 million paid by Household and/or Simonds." We further point out that Kowin stated in its post-hearing brief that the interest Household and/or Simonds paid was excluded from the $2,960,542 amount. (Household appdx. at 53).

over twenty years ($8,384,066), plus Kowin's capital contribution to Kowin-Simonds ($250). (Household appdx. at 53). Household argues that the lost profits portion of the second damage award "should be vacated or modified because the arbitrator exceeded his authority and manifestly disregarded long established, fundamental legal principles regarding the award of future lost profits." (Household brf. at 19-20). We disagree.

First, Kostner did not exceed his powers or fail to make a "mutual, final and definite award upon the subject matter submitted." 9 U.S.C. §10(d). To the best of our knowledge the arbitration agreement does not preclude the awarding of lost profits, and the subject matter of the case, the failed joint venture, clearly gave rise to the issue of lost profits.

Second, Household maintains that the arbitrator manifestly disregarded fundamental legal principles regarding future lost profits. While Household makes several arguments as to why Kowin should not recover lost profit damages, Kowin puts forth arguments as to why it should be entitled to lost profits. The issue, however, is not whether Kowin was or was not entitled to lost profits, but whether the arbitrator, in granting the award, deliberately disregarded the law.[5] We do not believe he did.

Deliberate disregard of the law means the arbitrator willfully ignored existing law when reaching his decision. Perhaps a court could infer deliberate disregard for the law when the law could not support the arbitrator's decision. The arbitrator in this case did not set forth his

[5] We also consider the statutory basis for vacating or modifying awards as mentioned by Household and as discussed in the previous paragraph.

reasons for awarding lost profits to Kowin, and it is not our job to speculate as to his reasoning or as to what law he relied upon. What we must consider is whether the facts, as we know them, are such that Kostner could have concluded that an award of lost profits was supported by law—whether or not we agree with his interpretation or application of the law. *Health Services*, 975 F.2d at 1267 (stating that to vacate the award there must be more than mere error in law or failure of the arbitrator to understand or apply the law); *Moseley*, 849 F.2d at 272 (noting that an award can be set aside only if injustice results and not because of an error on the part of the arbitrator in his interpretation of the law). And some courts have awarded lost profits to plaintiffs in what could be considered similar types of circumstances. For instance, although lost profits generally are not awarded in cases involving startup companies, some courts have awarded lost profits after finding that companies that appeared to be new businesses in fact were existing businesses that merely had taken new forms.[6] *See e.g.*, *Hallmark Insurance Administrators, Inc. v. Colonial Penn Life Insurance Co.*, 697 F.Supp. 319, 327 (N.D.Ill. 1988); *S. Jon Kreedman & Co. v. Meyers Brothers Parking-Western Corp.*, 130 Cal.Rptr. 41, 49 (Cal.App. 1976); *Maggio, Inc. v. United Farm Workers of America, AFL-CIO*, 278 Cal. Rptr. 250, 264 (Cal.App. 1991). We note that the profits figure is related to Household's own projections. There-

[6] In its brief, Kowin argues that the joint venture was not a start-up business in the traditional sense. Kowin points out that Household's Simonds division was the established leader in the file business, teaming up with an established leader in the file manufacturing business in China, to do what Simonds had done for 150 years. They further note that each of these two companies had a well established track record in the business.

fore, we cannot conclude that Kostner acted with deliberate disregard of fundamental legal principles when he awarded future lost profits.[7] The second award stands.

The third award of $3,500,000 represents restitution from Household on a theory of unjust enrichment. (Kowin post-hearing brf. at 62). The $3,500,000 which Household received for the equipment consisted of the $2,500,000 Kowin-Simonds loan and the $1,000,000 payment from the Bank of China.[8] The Kowin-Simonds loan was considered in the first award, and it was a miscalculation for the arbitrator to award Kowin the same damage award twice.[9] The third damage award therefore must be modified by deducting the $2,500,000 loan amount.

Our review of the arbitrator's award can go no further. Although Household makes several arguments for other reductions,[10] those items are not within the scope of our review. It is not our place to reevaluate every item Household thought should or should not have been included in the damages awarded. That was job of the arbitrator. Our

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[7] Kowin points to several other cases where lost profits were awarded in order to point out that the arbitrator could have been relying on a number of legal theories when he awarded lost profits.

[8] Kowin does not dispute that the $3,500,000 that Household received for the sale of the equipment was made up of these two components.

[9] We decreased this award by $1,250,000 for the amount which Household and/or Simonds had already paid.

[10] For example, Household argues that the third award should be reduced by an additional $1,000,000 because it does not represent a loss suffered by Kowin. In addition, Household maintains that the first damage award should be reduced by $500,000 to reflect the amount that Kowin allegedly received from Simonds when the joint venture was formed.

task is to examine the award on its face to determine whether or not grounds exist to vacate or modify it.

We conclude that the first award should be modified and reduced to $1,710,542 and the third award to $1,000,000.

/s/ JAMES B. MORAN
JAMES B. MORAN
Chief Judge, U.S. District Court

March 1, 1993.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

JUDGMENT IN A CIVIL CASE

IN THE MATTER OF THE ARBITRATION BETWEEN HOUSEHOLD MANUFACTURING, INC. AND KOWIN DEVELOPMENT CORPORATION

Case Number: 92 C 7250

☐ Jury Verdict. This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED The arbitration award is modified in part and confirmed in part. We conclude that the first award should be modified and reduced to $1,710,542 and third award to $1,000,000. Cause dismissed.

Date March 1, 1993

H. STUART CUNNINGHAM
Clerk

/s/ WILLIE A. HAYNES
(By) Deputy Clerk

[Dated March 9, 1993]

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

IN THE MATTER OF THE ARBITRATION BETWEEN	)	No. 92 C 7250
HOUSEHOLD MANUFACTURING, INC.,	)	Chief Judge Moran
and	)	Magistrate Judge Guzman
KOWIN DEVELOPMENT CORP.	)	

JUDGMENT ORDER

This action coming to be heard before the Court, the issues having been heard and a decision having been rendered, and the Court being fully advised in the premises,

IT IS HEREBY ORDERED THAT:

1. The arbitration award of the American Arbitration Association dated October 30, 1992 is confirmed in part and modified in part, in accordance with this Court's Memorandum and Order of March 1, 1993.

2. Judgment is entered, *nunc pro tunc*, March 1, 1993, in favor of Kowin Development Corporation and against Eljer Manufacturing, Inc., formerly known as Household Manufacturing, Inc., in the amount of $12,199,622. The amount of this judgment is determined as follows:

a. the first award of $1,710,542, plus interest in the amount of $99,157, computed at the rate of 10% per annum from August 2, 1992 to March 1, 1993, the date of the entry of this Final Judgment herein;

b. the second award of $8,384,316, plus interest in the amount of $279,854, computed at the rate of 10% per annum from October 31, 1992 to March 1, 1993, the date of the entry of this Final Judgment herein;

c. the third award of $1,000,000, plus interest in the amount of $725,753, computed at the rate of 10% per annum from November 27, 1985 to March 1, 1993, the date of the entry of this Final Judgment herein.

3. Pursuant to 28 U.S.C. § 1961, this Final Judgment of $12,199,622 shall earn post-judgment interest at the annual rate of 3.45%, compounded annually, from March 1, 1993, the date of entry of this Final Judgment.

4. The Court reserves jurisdiction to confirm, vacate or modify any award of attorneys' fees in favor of Kowin Development Corporation should the arbitrator, who still retains jurisdiction over this issue, make such an award.

Dated: 3/9/93

ENTER:

/s/ JAMES B. MORAN

(2)

FILED
MAY 18 1994
OFFICE OF THE CLERK

No. 93-1650

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN THE MATTER OF THE ARBITRATION BETWEEN: ELJER MANUFACTURING, INCORPORATED, formerly known as HOUSEHOLD MANUFACTURING, INCORPORATED,

Petitioner,

v.

KOWIN DEVELOPMENT CORPORATION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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No. 93-1650

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN THE MATTER OF THE ARBITRATION BETWEEN: ELJER MANUFACTURING, INCORPORATED, formerly known as HOUSEHOLD MANUFACTURING, INCORPORATED,

Petitioner,

v.

KOWIN DEVELOPMENT CORPORATION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

Respondent Kowin Development Corporation and Winston and Dorothy Ko, as successors-in-interest to Kowin Development Corporation (collectively "Kowin") hereby oppose the petition of Eljer Manufacturing, Inc. ("Eljer"), for a writ of *certiorari* to the United States Court of Appeals for the Seventh Circuit ("Petition").

I. STATEMENT OF THE CASE

Eljer's "Statement of the Case" is misleading and incomplete. Eljer incorrectly asserts that the Court of Appeals "declined to review that part of the award [involv-

ing future lost profits]." (Petition, p. 4.) As indicated subsequently, however, the Court of Appeals, while acknowledging that it was prohibited from reviewing the arbitration award for sufficiency of evidence (Opinion, App. p. 10),[1] nevertheless reviewed the evidence and thereby concluded that the evidentiary record "was clearly sufficient to support the award". (*Id.*)

It is also disingenuous for Eljer to represent that "the sole basis for the arbitrator's award was a one page five year sales and profit projection for the Joint Venture [which] no one in the proceeding could identify" (Petition, p. 5); and that "Kowin presented no evidence supporting its 15 year extrapolation [of lost profits]" (*id.*, p. 6). To the contrary, as indicated subsequently (*see* Section III A., *infra*), the arbitrator's award was not only supported by "clearly sufficient" evidence, in the words of the Court of Appeals, but all of such evidence was admitted *without objection* by Eljer and *without opposing evidence* offered by Eljer. Furthermore, the five year sales and profit projection disparaged by Eljer was, according to the evidence, prepared by Household and authenticated by witnesses. (*Id.*)

II. SUMMARY OF ARGUMENT

By its petition for *certiorari*, Eljer seeks review by the Supreme Court of only one issue, *i.e.*, whether an arbitration award under the Federal Arbitration Act, 9 U.S.C. sections 1 *et seq.* (the "Act") is subject to judicial review

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[1] The text of the Court of Appeals opinion is reprinted in Eljer's Petition beginning at page 1 of the Appendix. For purposes of convenience and consistency, citations to the opinion refer to the page number in Eljer's Appendix, *i.e.*, "Opinion, App. p. ____."

for insufficient evidence. Kowin contends that Eljer's petition should be denied for the following reasons:

1. As previously determined by the District Court and the Court of Appeals, the arbitrator's award of damages was supported, in the words of the Court of Appeals, by "clearly sufficient" evidence and, accordingly, the Supreme Court will have no occasion to reach the only federal question raised by Eljer in its Petition. (*See* Section III A., *infra.*)

2. Eljer has not, and cannot, demonstrate that its Petition raises any important federal question which has not previously been addressed by the Supreme Court. This Court has previously opined that an arbitration award under the Act is not reviewable for insufficiency of evidence. *United Paperworkers International Union, AFL-CIO et al. v. Misco, Inc.*, 484 U.S. 29, 38, 108 S. Ct. 364, 986 L. Ed. 286 (1987). (Section III B., *infra.*) There is no post-*Misco* relevant conflict in principle among the circuits with respect to the scope of judicial review. (*See* Section III B., *infra.*)

3. In deference to non-judicial dispute resolution, the Supreme Court has routinely denied petitions for *certiorari* raising similar issues. (*See* Section III B., *infra.*)

4. Eljer is impermissibly seeking review on *certiorari* of state law principles regarding benefit-of-the-bargain damages. Essentially, Eljer claims that the arbitrator erred by allegedly awarding speculative lost profits in a new enterprise which, according to Eljer, were unavailable under applicable state law. The Court of Appeals properly rejected this argument by observing that a state law exception to the "new business rule" obtained in this case. The application of such state law principles does not involve a federal question. Moreover, any error of law com-

mitted by the arbitrator with respect to the application of such principles would not be reviewable. *See Misco*, 484 U.S. at 38. (*See* Section III C., *infra.*)

5. The decision by the Court of Appeals does not establish novel principles and will not inhibit arbitration. The Court of Appeals' decision applied principles of review based upon decisions of this Court and the circuits which have been in the public domain for years. There is no evidence whatever to suggest that this case is unique, unprecedented or controversial. Indeed, Eljer seeks to expand judicial review to facilitate inquiry as to the sufficiency of arbitration evidence, an enterprise which will deter, rather than encourage, arbitration under the Act. (*See* Section III D., *infra.*)

III. ARGUMENT

A. The Question Presented Is Academic Since The Arbitrator's Award Of Damages Was Supported By Substantial Evidence.

All of the arguments presented by Eljer in its Petition are predicated upon the false premise that the arbitrator's award of lost profits was not supported by *any* evidence. It is astonishing that Eljer persists in the assertion that the lost profits award of the arbitrator was not supported by any evidence despite the incontrovertible record to the contrary. As stated by the Court of Appeals in its opinion:

> In fairness to the arbitrator, even if we could vacate the award we would not do so because the evidence was clearly sufficient to support the award. Kowin's claim for lost profits was based on Eljer's own representations about the venture's profitability and based on the purchase of a certain number of files every year.

(App. p. 10.)

The Court of Appeals' conclusion was amply supported by the record. The arbitration evidence respecting lost profits included: The Joint Venture Agreement and Sales Agreement, which specifically required the purchase of 34.67 million files during the first five years of the Joint Venture (R 42-6 at HX 21);[2] the profit projection prepared by Household over the first five year period (*Id.*, at HX 12); Household's marketing plan, which projected market increases worldwide of 2 percent to 3 percent from the sixth to twentieth year of the Joint Venture (*Id.*, at HX 1); production forecasts indicating Joint Venture production capacity of 20 million steel files per annum (*Id.*, at KX 22, pp. 13-14); representations of 21 percent profits on Chinese sales and 47 percent profits on worldwide sales outside of China (*Id.*, KX 22, p. 14); production cost accounting figures (*Id.*, KX 22, pp. 25-26); representations of net profits equal to U.S.$9,161,500 for the first five years and annual net profits thereafter of U.S.$2,000,000 for "each party" from the fifth year onward (*Id.*, KX 22, p. 27); detailed "annual profit" analysis (*Id.*, KX 22, pp. 30-32); and uncontested evidence that all financial figures and projections were provided by Household (R 42-1 at RT 126:5-16, 63:18-64:16). Indeed, Household represented that it could purchase all the files the Joint Venture was capable of producing. (R 42-1 at RT 91:19-93:6, 132:6-133:4; R 42-6 at KX 22, p. 10.)

Eljer failed to produce *any* contrary evidence. It never suggested *any* alternative to the amount of lost profits sought by Kowin. Eljer merely challenged the recoverability, as a matter of law, of benefit of the bargain damages;

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[2] Evidentiary citations are to the record before the Court of Appeals and follow the convention used by the parties in their appellate briefs.

Eljer did not challenge the computation of the amount or the sufficiency of the evidence to support an award. This Court has consistently held that arbitration awards are not reviewable under the Act for mere error of law. *United Paperworkers International Union, AFL-CIO, et al. v. Misco, Inc.*, 484 U.S. 29, 38, 108 S. Ct. 364, 986 L. Ed. 286 (1987).

It is obvious, therefore, that Eljer proposes to seek *certiorari* for the review of issues which are irrelevant to this record. This Court would have no occasion to consider these issues unless it first determined that the lost profits award in this case was not supported by any evidence. Since there was not only some evidence but, in the Court of Appeals' words "clearly sufficient" evidence, Eljer is effectively asking this Court to render an impermissible advisory opinion. U.S. Const. Art. III; *Flast v. Cohen*, 392 U.S. 83, 96 (1942).

B. Eljer Has Failed To Raise An Important Question Meriting *Certiorari*.

This Court has already ruled dispositively with respect to the sole issue raised by Eljer, *i.e.*, whether an arbitration award under the Act is reviewable for insufficient evidence.

For example, this Court has held that an award under the Act is not subject to judicial review for errors of law or fact (*Misco*, 484 U.S. at 38); that the award must draw its essence from the arbitration agreement (*id.*, 484 U.S. at 36, *citing United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 597, 80 S. Ct. 1358, 4 L. Ed. 2d 1424 (1960)); and that the arbitrator is not empowered to "dispense his own brand of industrial justice" (*id.*). These principles are equal to the task here and compel the conclusion that the Court of Appeals did not commit error in affirming the arbitrator's award of lost profits.

The Supreme Court has repeatedly denied *certiorari* to clarify further the standards of review under the Act. Of the fifteen cases cited by Eljer to evidence what it characterizes as "existing disarray in the circuits", eight were decided before this Court's decision in *Misco, supra.*[3] This Court was asked to grant *certiorari*, but declined, three times.[4] Eljer even cites the decisions of this Court in support of the proposition that *certiorari* is required in order to clarify the alleged confusion among the circuits.[5]

Post-*Misco* circuits have in effect examined arbitrations under the Act to determine if the arbitrator "dispensed his own brand of justice" or acted beyond his powers under the standards of review previously confirmed by the Supreme Court. *See United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593, 597, 80 S. Ct. 1358, 4 L. Ed. 2d 1424 (1960). The circuits have applied these principles by inquiring whether the award was "completely irrational" or "unfounded in reason and fact"

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[3] *See Shearson Hayden Stone, Inc. v. Liang*, 653 F.2d 310 (7th Cir. 1981); *National Railroad Passenger Corp. v. Chesapeake and Ohio Ry. Co.*, 551 F.2d 136 (7th Cir. 1977); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930 (2d Cir. 1986); *Gunther v. San Diego & A.E.R. Co.*, 382 U.S. 257 (1965); *Stroh Container Co. v. Delphi Industries, Inc.*, 783 F.2d 743 (8th Cir. 1986); *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

[4] *See Detroit Coil Co. v. International Association of Machinists & Aerospace Workers*, 594 F.2d 575 (6th Cir. 1979), *cert. denied*, 444 U.S 840 (1979) (factual irrationality); *Stroh Container Co. v. Delphi Industries, Inc.*, 783 F.2d 743 (8th Cir. 1986), *cert. denied*, 476 U.S. 1151 (1986) (nonstatutory grounds); *Lee v. Chica*, 983 F.2d 883 (8th Cir. 1993), *cert. denied*, 114 S. Ct. 287 (1993).

[5] *Wilko v. Swan*, 346 U.S. 427 (1953), *overruled on other grounds*, 490 U.S. 477 (1989); *Gunther v. San Diego and A.E.R. Co.*, 382 U.S. 257 (1965); *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960).

or necessarily involved a "manifest disregard of the law" (*McIlvoy v. PaineWebber, Inc.*, 989 F.2d 817, 820 and note 2 (5th Cir. 1993)); or was "arbitrary and capricious" (*Advest, Inc. v. McCarthy*, 914 F.2d 6, 9, and note 6 (1st Cir. 1990); or had a "rational basis" (*Jenkins v. Prudential-Bache Securities, Inc.*, 847 F.2d 631, 634 (10th Cir. 1988); or was irrational (*Raiford v. Merrill Lynch, Pierce, Fenner & Smith*, 903 F.2d 1410, 1413 (11th Cir. 1990); or failed to derive its "essence from the contract" (*Executive Life Insurance Co. v. Alexander Insurance, Ltd.*, 999 F.2d 318, 320 (8th Cir. 1993)). The descriptive phrases used by the circuits, although differing in nomenclature, are merely the rationale under which this Court's standards of review above summarized have been applied. There is no "disarray among the circuits." Rather, the circuits have predictably adopted the standards articulated by the Supreme Court to the specifics of each case. This Court has done the same. *See Wilko v. Swan*, 346 U.S. 427, 436, 74 S. Ct. 182, 98 L. Ed. 168 (1953), *overruled on other grounds*, 490 U.S. 477 (1989) (where this Court coined the phrase "manifest disregard of the law.")

In any event, the decision of the Court of Appeals in this case would be affirmed under any of the rationale in use among the circuits. Interestingly, Eljer does not maintain otherwise except in the narrow case where there is no evidence whatever to support an award. As previously indicated, however, no good faith argument can be advanced here that the award of lost profits was not supported by *any* evidence. (*See* Section II A., *supra*.)

C. Eljer Is Impermissibly Seeking Review On *Certiorari* Of State Law Regarding Benefit Of The Bargain Damages.

Eljer seeks *certiorari* on the pretext that it is necessary for this Court to clarify the scope of judicial review under the Act, claiming that the arbitrator erred here by allegedly awarding speculative lost profits in a new enterprise which profits were, accordingly, unavailable under applicable state law. In effect, therefore, Eljer is requesting this Court to reevaluate the arbitrator's conclusion of law that lost profits were not speculative and were available in this case under state law.

The Court of Appeals properly declined to overturn the arbitrator's decision in this respect:

> Even if an arbitrator's mistake of law permitted us to modify his decision, we still would not do so here. The premise of a so-called "new business" rule is that the success of a new enterprise is ordinarily uncertain. Where, however, the enterprise is simply an absorption or extension of a previously established successful operation and the venture's future is less in doubt, the awarding of future lost profits is not, as a matter of law, forbidden. *GHK Associates v. Mayer Group, Inc.*, 274 Cal. Rptr. 168 (Cal. App. 1990); *Hallmark Insurance Administrators v. Colonial Penn Life Ins.*, 697 F. Supp. 319, 327 (N.D. Ill. 1988), aff'd. 990 F.2d 984 (7th Cir. 1993). Kowin argued that the Chinese venture fell under this exception and the arbitrator could have made his decision on this basis.

(Opinion, App. p. 9.)

Second, even if the arbitrator had committed error in construing applicable law, he did so on the basis of extensive legal arguments presented by both sides citing federal and state authority. Accordingly, it cannot be said that his rulings constituted his "own brand of industrial

justice" (*Misco*, 484 U.S. at 36), or that his implied ruling did not "draw its essence" from the arbitration agreement (*id.*). It is uniformly established, including in the Supreme Court, that arbitration awards under the Act are not reviewable for errors of law. *Misco*, 484 U.S. at 38.

Finally, it is absurd to suggest that this Court should grant *certiorari* for the purpose of resolving state law questions concerning the recoverability of benefit of the bargain damages. *Certiorari* is not available to review state law where no controlling federal question is presented. *See* Supreme Court Rule 10 (subparagraphs (a) through (c) of Rule 10.1 clearly contemplate review of "federal questions" only).

D. The Court Of Appeals' Decision Here Will Neither Undermine Confidence In Arbitrations Nor Discourage Their Use.

Eljer proffers no evidence whatever, nor could it do so, to support its self-serving assertion that the Court of Appeals' decision here will undermine public confidence in the arbitration process. As relevant here, the Court of Appeals' decision is based upon decisions of this Court and the circuits which have been in the public domain for years. Nevertheless, the public is resorting to non-judicial dispute resolution, including arbitrations under the Act, with increasing frequency. The Court of Appeals did not promulgate any novel standards of review.

Indeed, Eljer would have this Court grant *certiorari* for the purpose of encouraging judicial review of arbitration awards through inquiry into the sufficiency of evidence. As has been recognized by this and other courts, such an exercise would discourage, rather than promote, resort to arbitration as a simple, speedy, cost effective and final

means of resolving commercial disputes. *See, e.g., Flender Corp. v. Techna-Quip Co.*, 953 F.2d 273, 279 n. 4 (7th Cir. 1992) ("Judicial review [of arbitration awards] has been thus restricted in order to further the objective of arbitration, which is to enable the parties to resolve disputes promptly and inexpensively, without resort to litigation . . . .").

If there is some risk of uncertainty associated with the arbitration process, that is simply the risk which the parties have contractually accepted to achieve the efficiency and certainty of arbitration. It is worth noting that it was Eljer, and not Kowin, which compelled arbitration and selected the forum.

One of the significant advantages of arbitration is that the contracting parties are free to incorporate into their agreement any provisions which they believe necessary to mitigate potential uncertainty and control the activities of the arbitrator. These privately negotiated procedures must be honored by the arbitrator, and the courts. *Volt Information Sciences v. Leland Stanford Jr. University*, 489 U.S. 468, 478, 109 S. Ct. 1248, 103 L. Ed. 2d 488 (1989).

The parties are free, as in this case, to have their disputes arbitrated by mutually acceptable arbitrators. *Misco*, 484 U.S. at 37. They may exclude selected issues from the scope of arbitration (*Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 628, 105 S. Ct. 3346, 84 L. Ed. 2d 444 (1985)); or require the arbitrator to render detailed findings of fact and conclusions of law (*Western Employers Insurance Co. v. Jefferies & Co.*, 958 F.2d 258, 261 (9th Cir. 1992); or limit the nature or scope of remedies available (*Misco*, 484 U.S. at 41). Indeed, in this case the contracting parties could have specifically provided for liquidated or other forms of damage so as to obviate potential liability for lost profits; or they could

have agreed in the arbitration clause to limit the arbitrator's right to award lost profits. It is this flexibility which enhances the attraction of arbitration to commercial litigants. Judicial activism would merely inhibit the process. *Flender Corp.*, 953 F.2d at 279 n. 4.

IV. CONCLUSION

For the foregoing reasons, it is respectfully submitted that Eljer's Petition for writ of *certiorari* should be denied.

Respectfully submitted,

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REPLY BRIEF

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No. 93-1650

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

IN THE MATTER OF THE ARBITRATION BETWEEN: ELJER MANUFACTURING, INCORPORATED, formerly known as HOUSEHOLD MANUFACTURING, INCORPORATED,

Petitioner,

v.

KOWIN DEVELOPMENT CORPORATION,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF OF PETITIONER

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REPLY BRIEF OF PETITIONER

Petitioner Eljer Manufacturing ("Eljer") replies to the brief of respondent Kowin Development Corporation and Winston and Dorothy Ko, as successors-in-interest to Kowin Development Corporation (collectively "Kowin"), in opposition to Eljer's petition for a writ of certiorari (the "Petition").

ARGUMENT

The Petition asks this Court to review a judgment of the Seventh Circuit Court of Appeals which, in conflict with decisions from the Second, Third, Sixth and Ninth

Circuits, barred review of an arbitration award for sufficiency of the evidence. That part of the judgment for which Eljer seeks review—the Court of Appeals' affirmance of an extrapolation of fifteen years' lost profits from a five-year sales and profit projection—is not supported by any evidence in the record. Rather than squarely addressing the issue before this Court, Kowin mischaracterizes the Petition, misrepresents the Seventh Circuit's opinion and misstates the law of this Court and the circuits regarding the standard of review for arbitration decisions.

Aside from generalities about arbitration, Kowin's brief makes only two specific arguments about why this Court should not hear this case. First, Kowin claims that the question presented in the Petition is academic because the Seventh Circuit found that the arbitrator's award was supported by substantial evidence. Second, Kowin claims that this Court has already decided whether an arbitration award is reviewable for sufficiency of the evidence. Both of Kowin's arguments are simply wrong.

I.

THE QUESTION PRESENTED—WHETHER AN ARBITRATION AWARD IS REVIEWABLE TO DETERMINE IF IT IS BASED ON SUFFICIENT EVIDENCE OR IS NOT IRRATIONAL—IS NOT ACADEMIC BECAUSE THE SEVENTH CIRCUIT DID NOT HOLD THAT THE FIFTEEN-YEAR DAMAGES AWARD WAS BASED ON SUFFICIENT EVIDENCE.

Kowin claims that the issue presented by this petition is "academic" because the Court of Appeals determined that the arbitrator's award of lost profits was supported by sufficient evidence. (Kowin brief at 4-6) The Seventh Circuit's opinion refutes Kowin's position.

In the courts below, Eljer made separate and distinct challenges to the evidentiary sufficiency of the two parts of the lost profits award. Eljer argued that the $1,364,372 portion of the award stemming from a five-year profit projection was based on profoundly insufficient evidence. Eljer further contended that the $7,019,944 fifteen-year extrapolation of lost profits after that five years had *no* evidentiary support.

As its opinion makes clear, the Seventh Circuit responded separately to these arguments. The court refused to adopt sufficiency of the evidence as a ground to set aside any arbitration award; however, the court reviewed the basis for the five-year award and held that the award was supported by sufficient evidence. (*See* Opinion at App. 10 and Petition at 7) In contrast, with respect to the fifteen-year award, the Court of Appeals concluded it lacked the authority to review the award (without citation to any legal authority) and summarily affirmed the award without examination of its evidentiary basis. The court noted that "[a] question as to the sufficiency of the evidence before the arbitrator simply does not trigger the review powers of this court." (*See* Opinion at App. 10 and Petition at 8) The only question presented to this Court concerns the Seventh Circuit's holding with respect to that fifteen-year award. (*See* Petition at 8)

To confuse the issue, Kowin quotes only the Seventh Circuit's discussion of the first five years' damages and carefully avoids any mention of the very next paragraph, which concerns the fifteen-year extrapolation. (*Compare* Petition at 7-8 with Kowin brief at 4) In fact, Kowin's entire brief focuses on the five-year award, even though it is *not* the subject of the Petition.

Kowin similarly attempts to mislead this Court by asserting that the arbitration record supports the Court of Appeals' conclusion regarding sufficiency of the evidence. (Kowin brief at 5) None of the evidence Kowin proffers is directed to the fifteen-year extrapolation from the five-year projection. In any event, since the Seventh Circuit did not hold that the extrapolation was based on sufficient evidence, Kowin's recitation of record evidence misses the point.

Eljer has presented a question for review which was central to the result in this case: an award of $7 million of "future lost profits" damages without any supporting evidence. Resolution of this question is also pivotal to the outcomes of the future arbitrations which are submitted for judicial review in the Seventh Circuit and other circuits. Eljer respectfully asks this Court to reject Kowin's attempts at obfuscation and to review the judgment of the Seventh Circuit.

II.

THIS COURT IN *MISCO* DID NOT DECIDE WHETHER AN ARBITRATION AWARD IS REVIEWABLE TO DETERMINE IF IT IS BASED ON SUFFICIENT EVIDENCE OR IS NOT IRRATIONAL.

Continuing its effort to avoid addressing the question presented, Kowin asserts that this Court has already ruled dispositively on the issue. (Kowin brief at 3, 7) In a strained interpretation of *United Paperworkers International Union v. Misco*, 484 U.S. 29 (1987), Kowin claims *Misco* holds that an arbitration award under the Act is not reviewable for insufficiency of evidence. (*Id.*) *Misco* in no way stands for that proposition.

In *Misco*, an employer sought to uphold the Court of Appeals' vacation of a labor arbitration award rendered pursuant to a collective bargaining agreement. *Misco*, 484 U.S. at 35-36. The employer argued, *inter alia*, that the arbitrator had made erroneous factual findings. *Id.* at 36. This Court rejected that contention and held that arbitration awards were not reviewable for claims of factual or legal error. *Id.* at 36-38.[1]

Misco did not even address, much less resolve, the question Eljer has presented here. Rather, *Misco* held that a court could not second guess the *correctness* of facts found by an arbitrator. Here, Eljer does not, and cannot, challenge whether the arbitrator correctly viewed the evidence underlying the extrapolation, because there were no factual findings and there was no evidence.

While the basis for this Petition is a split in the circuits, this Court's decision in *Misco* actually offers some support for Eljer's position. Notably, *Misco* held:

> "To resolve disputes about the application of a collective-bargaining agreement, an arbitrator *must find facts* and a court may not reject those findings simply because it disagrees with them."

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[1] In contrast to the commercial arbitration at issue here, which is subject to the Federal Arbitration Act, *Misco* concerned a labor arbitration conducted pursuant to the Labor Management Relations Act of 1947. *See Misco*, 484 U.S. at 37 & 40 n.9. Eljer does not challenge the relevance of general arbitration principles from labor arbitrations in commercial arbitrations. However, since the Federal Arbitration Act was not invoked in *Misco*, Kowin mischaracterizes the case as "dispositive" on "whether an arbitration award *under the Act* is reviewable for insufficient evidence." (Kowin brief at 6; emphasis supplied)

Id. at 38. (emphasis supplied) This says plainly that construction of the facts is necessary to resolve an arbitration dispute, and suggests there must be some evidence to support an arbitrator's decision.[2]

Kowin's misinterpretation of *Misco* is no more than a ruse by which it seeks to avoid confronting the split in the circuits. The Petition sets forth cases from the Second, Third and Ninth Circuits decided after *Misco* that permit examination of arbitration awards for evidentiary sufficiency or irrationality. *See, e.g., Pacific Reinsurance Management Corp. v. Ohio Reinsurance Corp.*, 935 F.2d 1019, 1025-26 (9th Cir. 1991); *Mutual Fire, Marine & Inland Ins. Co.*, 868 F.2d at 56; *In re Arbitration No. AAA13-161-0511-85 under Grain Arbitration Rules*, 867 F.2d 130, 135 (2d Cir. 1989). Kowin is notably silent with respect to this authority. These decisions are contrary to Kowin's interpretation of *Misco* and also to the Seventh Circuit's ruling.

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[2] *Misco's* holding is not inconsistent with judicial review of arbitration decisions for sufficiency of the evidence or irrationality. Courts which permit such review recognize that an arbitration decision cannot be overturned for erroneous fact finding. These courts do not examine the correctness of facts found, but simply require the decision to be grounded in *some* facts. *See, e.g., Mutual Fire, Marine & Inland v. Norad Reinsurance Co., Ltd.*, 868 F.2d 52, 56 (3d Cir. 1989); *Storer Broadcasting Co. v. American Federal of Radio & Television Artists*, 600 F.2d 45, 47 (6th Cir. 1979), *cert. denied*, 454 U.S. 1099 (1981).

Review for sufficiency of the evidence or irrationality is also consistent with the longstanding principles that an arbitrator's award must be derived from the essence of the agreement and cannot simply reflect the arbitrator's own notions of justice. (*See* Petition at 18-19).

Kowin does concede that some courts have examined arbitration awards to determine whether the awards were, for example, "unfounded in reason and fact" or "completely irrational." (Kowin brief at 7-8) Yet Kowin claims, without any analysis of the lower court cases, that this Court need not clarify these different standards being used in different circuits, because they are simply different "descriptive phrases" for the same type of review. (*Id.* at 8) The disarray in the circuits is apparent from Kowin's refusal to even acknowledge the contrary authority Eljer advanced from the Second, Third, Sixth and Ninth Circuits (*see* Petition at 10-16), from Kowin's own lengthy inventory of some of the varying standards in use by the lower courts and from the differing results being reached in these cases. (*See* Kowin brief at 7-8)

As both Eljer and Kowin demonstrate, one federal statute—the Federal Arbitration Act—has caused the circuits to develop a host of review standards. Eljer respectfully requests this Court to review the judgment of the Seventh Circuit to ensure that lower courts act consistently as to review for evidentiary sufficiency or irrationality, and to alleviate the increased confusion the Seventh Circuit's judgment would generate as courts and advocates begin to cite and rely on a new and different standard for review.

CONCLUSION

For all the foregoing reasons, this Court should grant Eljer's petition for certiorari.

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